UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 07-1397

OFFICIAL COMMITTEE OF UNSECURED
CREDITORS OF ALLEGHENY HEALTH,
EDUCATION AND RESEARCH FOUNDATION,

Appellant

v.

PRICEWATERHOUSECOOPERS, LLP

Appeal from the United States District Court
for the Western District of Pennsylvania
(D.C. Civil Action No. 00-cv-00684)
District Judge: Honorable David Stewart Cercone

Argued April 15, 2008

Before: AMBRO, JORDAN, and MICHEL,* Circuit Judges

(Filed: July 1, 2008)

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*Honorable Paul R. Michel, Chief Judge, United States Court of Appeals for the Federal Circuit, sitting by designation.

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CERTIFICATION OF QUESTION OF LAW

This matter came before the United States Court of Appeals for the Third Circuit on appeal from a final judgment of the United States District Court for the Western District of Pennsylvania, in which the District Court granted summary judgment in favor of defendant PricewaterhouseCoopers, LLP ("PwC"), as the Court deemed the doctrine of *in pari delicto* (that a party in equal fault with another cannot recover from the other party) to bar the claim against PwC.

The panel, (Judges Ambro, Jordan, and Michel), having read the briefs and submissions of the parties, having heard oral argument, and having reviewed applicable cases of the Pennsylvania Supreme, Superior and Commonwealth Courts, believes the appeal raises important and unresolved questions concerning the interaction between the *in pari delicto* doctrine and the imputation of an agent's fraud to his principal under Pennsylvania law. The panel unanimously agreed to certify these questions to the Supreme Court of Pennsylvania by way of the certification procedure outlined in Third Circuit Local Appellate Rule Misc. 110 and Internal Operating Procedure 10.9. Accordingly, we respectfully request that the Supreme Court of Pennsylvania accept this certification.

I. Facts and Procedural History

A. The Debtor's Growth

The debtor is the Allegheny Health, Education, and Research Foundation ("AHERF"), a Pennsylvania non-profit corporation that, prior to its liquidation, provided a wide range of healthcare services, including operating hundreds of physicians' practices, 14 hospitals, and two medical schools.

From the mid-1980s, AHERF, under the leadership of CEO Sherif Abdelhak, tried to build a region-wide "integrated delivery system" through an aggressive program of acquisitions. According to the then-popular theory, a health system could make money by building a network of hospitals, physician practices, and medical schools. The schools would staff the hospitals with residents; the physician practices would, through referrals, provide the hospitals with patients; and the hospitals would bring in substantial net income through the provision of high-dollar specialty care. Industry publications and news articles from the 1990s discussing the integrated-delivery-system model indicate that it was, at least for a time, the business model *du jour* for large healthcare providers.[1]

AHERF pursued the integrated-delivery-system model by acquiring hospitals and physician practices. When acquired, these entities generally were losing money. The hospitals, it was thought, could be rehabilitated through better management, as well as operational efficiencies, price reductions from mass contracts with vendors, and economies of scale. The physician practices, on the other hand, would perform better, but would primarily serve as "loss leaders" to generate patients for the hospitals' high-dollar specialist care.

AHERF's implementation of the integrated-delivery-system model failed. By 1996, the company was suffering substantial operating losses. Cost savings and

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[1] *See, e.g.*, Rhonda L. Rundle, *The Great Divide: A Tale of Two Doctors: One Who Embraces Managed Case, the Other Who Assails It*, Wall St. J., Oct. 26, 1997, R11; Benjamin S. Snyder, *Future Lies in Managed Care*, San Jose Mercury News, Sept. 7, 1997, 7P; George H. Pink & Tom Closson, *An Affordable Health-Care Delivery System that Works*, Toronto Star, Sept. 26, 1996, A27; Robert Pear, *Budget Cuts Stall Broader Services in Medicare Plan*, N.Y. Times, Nov. 26, 1995, A1 ("[H]ealth care providers are branching out into new areas, so one company can serve all of a patient's medical needs from birth to death. Health care executives say such full-service arrangements, known as integrated delivery systems, are good for patients and good for the company's bottom line."); Suzanne White & Richard Lamm, *Adam Smith Reshapes Colorado's Health Care*, Denver Post, Nov. 11, 1997, B-07; George Anders & Rhonda L. Rundle, *As Wellpoint Spinoff Attracts Interest, Other Blue Cross Plans Consider Moves*, Wall St. J., Feb. 16, 1995, A3 (Blue Cross executive describes building integrated delivery systems as "what everyone else in health care is doing").

efficiency gains were not being realized, and cash was beginning to run out.

B. PwC's 1996 and 1997 Audits of AHERF

AHERF had, for decades, employed the services of Coopers and Lybrand (now PwC) to audit its financial statements. Specifically, PwC was engaged to provide an opinion on AHERF's financial statements to its board of trustees. PwC could either provide a "clean" opinion, which would indicate that the statements were accurate and complied with generally accepted accounting principles ("GAAP") and generally accepted auditing standards ("GAAS"), or an "adverse" opinion, which would identify deficiencies in the statements.

By their own admission, a group of high-level AHERF officers, led by David McConnell (AHERF's chief financial officer) and operating with Abdelhak's approval, knowingly misstated AHERF's finances in the figures they provided PwC for the 1996 audit of AHERF. These misstatements were designed to conceal how precarious AHERF's financial position was, and to make it look as though the integrated-delivery-system model was beginning to pay dividends in the form of cost savings and increased net income. As alleged by the Official Committee of Unsecured Creditors (the "Committee"), standing in the shoes of AHERF, PwC's audit should have brought these misstatements to light, but, rather than issuing an adverse opinion as GAAP and GAAS required, PwC knowingly assisted in the officers' misconduct by issuing a "clean" opinion. According to the Committee, the officers and PwC repeated their misconduct in 1997.

The result of these misdeeds, according to the Committee, was that the AHERF board was under the false impression that the company was in relatively good financial shape. Thus, the board did not intervene in management's business strategy, and instead allowed Abdelhak to continue making acquisitions.

C. Bankruptcy

By the spring of 1998, Abdelhak and McConnell were unable to prevent board members from perceiving that AHERF's financial position was dire. Suppliers began complaining directly to board members about not being paid, and doctors threatened to quit over Allegheny General Hospital's lack of resources. As AHERF's financial condition leaked, board members became less confident in Abdelhak's leadership, and in early June 1998 they removed him as President and CEO. They also removed McConnell as CFO. Soon thereafter, they disengaged PwC and issued warnings that their 1997 financial statements were not reliable.

AHERF's corrective measures came too late, and in July 1998 it filed for relief under Chapter 11 of the Bankruptcy Code.

D. This Action

In this adversary proceeding, the Committee, on behalf of AHERF, asserted three causes of action against PwC: (1) breach of contract, (2) professional negligence, and (3) aiding and abetting a breach of fiduciary duty. PwC moved for summary judgment on numerous grounds. The District Court granted summary judgment on the sole ground that AHERF was *in pari delicto* with PwC, and thus the Committee could not recover.

This appeal followed.

II. Legal Background

The District Court's grant of summary judgment in AHERF's favor rests on two holdings: (1) that the AHERF officers' fraud in misstating the company's finances is imputed to the corporation, and (2) that the doctrine of *in pari delicto* prevents AHERF, as a fellow fraudfeasor, from recovering against PwC on the causes of action asserted. We discuss the legal background of each question in turn.

A. Imputation

The parties have spent substantial time arguing which test applies to determine whether an agent's fraud is imputed to his principal, particular when, as here, imputation is being invoked by an allegedly non-innocent third party (PwC) for the purpose of shielding itself from laibility.

According to PwC and the District Court, the test is whether the principal received any benefit from the agent's fraud. If so, the conduct is imputed. This test derives initially from *Todd v. Skelly*, 120 A.2d 906, 908 (Pa. 1956), in which the Supreme Court of Pennsylvania wrote that "[w]here an agent acts in his own interest which is antagonistic to that of his principal, or commits a fraud for his own benefit in a matter which is beyond the scope of his actual or apparent authority or employment, the principal *who has received no benefit therefrom* will not be liable for the agent's tortious act." *Id.* (emphasis added). According to PwC, the Court was saying that if a principal derives any benefit from an agent's act, even if the agent was acting entirely for his own benefit and the principal did not ratify the act, then the principal becomes liable. This "no benefit" language has carried through to the decision of our Court in *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340, 358 (3d Cir. 2001).

In contrast, the Committee argues that the test centers on the agent's subjective intent. If the agent intended to serve the principal, the fraud is imputed; if, however, the agent intended only to serve himself, the fraud is not imputed. This is the approach of the Restatements of Agency. *See* Restatement (Third) of Agency § 5.04 cmt. c (2006) (explaining importance of agent's subjective intent); Restatement (Second) of Agency § 282 cmt. c (1958) (referring to *respondeat superior* test, which shields principal from liability when agent is acting without any intent to serve principal, but does not shield principal from liability when agent acts from mixed motive); Restatement (First) of Agency § 282 cmt. b (1933). Moreover, this approach is familiar in Pennsylvania law, as it is the approach followed in *respondeat superior* cases. *See Dillow v. Myers*, 916 A.2d 698, 700 n.4 (Pa. Super. Ct. 2007) (noting that *respondeat superior* liability attaches if, *inter alia*, the employee's wrongful act was "'actuated, at least in part, by a purpose to serve the employer'" (quoting *Costa v. Roxborough Memorial Hosp.*, 708 A.2d 490, 193 (Pa. Super. Ct. 1998))). In addition, it appears to be the standard the Supreme Court of Pennsylvania applied in several pre-*Todd* cases, none of which employed *Todd*'s "no benefit" language. *See, e.g.*, *Gordon v. Continental Cas. Co.*, 181 A. 574, 576-77 (Pa. 1935); *Nat'l Bank of Shamokin v. Waynesboro Knitting Co.*, 172 A. 131, 134 (Pa. 1934); *Gunster v. Scranton Illuminating, Heat & Pwr. Co.*, 37 A. 327, 337-38 (Pa. 1897). The

Committee argues that the "no benefit" language in *Todd* came out of the Court's recital of the circumstances of that case and did not alter the prior rule.

Under normal circumstances, we would resolve the question of which proposed test applies on the basis of the cases cited to us, without certifying a question of law to the Supreme Court of Pennsylvania. But this case includes a dimension not previously considered in the Pennsylvania cases cited to us: the party invoking imputation purportedly is not an innocent third party harmed by an agent's action on behalf of the principal; rather, the party invoking imputation is an alleged co-conspirator with agents (AHERF officers) that purportedly harmed the principal (AHERF). Thus, imputation allegedly is being used to shield a non-innocent party from liability that would otherwise attach.

This context raises a new question because the Supreme Court of Pennsylvania has observed that the primary rationale for imputing an agent's fraud to his principal is that doing so protects innocent third parties who do business with agents of the principal.

> [Imputation] is not based upon any presumed authority in the agent to do the acts, but on the ground of public policy, that it is more reasonable that when one of two innocent persons must suffer from the wrongful act of a third person, that the principal who has placed the agent in the position of trust and confidence should suffer, rather than an innocent stranger.

Aiello v. Ed Saxe Real Estate, Inc., 499 A.2d 282, 559 (Pa. 1985). Because that rationale does not fit the alleged facts before us, the Committee plausibly argues that imputation is inappropriate.

The Supreme Court of New Jersey has taken a position similar to the one the Committee urges. In *NCP Litig. Trust v. KPMG, LLP*, 901 A.2d 871, 882 (N.J. 2006), that Court held that third-party auditors "who contributed to the misconduct cannot invoke imputation. . . . [T]herefore[,] . . . a claim for negligence may be brought on behalf of a corporation against the corporation's allegedly negligent third-party auditors for damages proximately caused by that negligence." In so holding, the Court noted that, when a corporate officer's misconduct is imputed to the corporation in an audit situation, imputation prevents the fair apportioning of liability among the corporation, offending officers, and offending accountants, because it allows the offending accountants to bear none of the loss. *Id.* at 880. The Court found this result troublesome, as "[a]bsolving negligent corporate auditors 'is difficult to rationalize and to justify or explain in any satisfying or comprehensive way.'" *Id.* (quoting Deborah A. DeMott, *When Is a Principal Charged with an Agent's Knowledge?*, 13 Duke J. Comp. & Int'l L. 291, 319 (2003)).[2]

Were we to adopt the language in *Aiello*, it would create substantial tension with our decision in *Lafferty*, where we imputed fraudulent conduct to shield a non-innocent party without addressing whether this was a departure from established Pennsylvania law. Moreover, at its heart the question presented requires a policy judgment. On one hand, a court might believe, as the *NCP* Court did, that preventing a non-innocent from invoking the law of imputation properly deters misconduct on the part of persons, like accountants

[2] Professor DeMott is the reporter for the Restatement (Third) of Agency.

and auditors, who regularly deal with the agents of corporations. 901 A.2d at 880. On the other hand, one could argue, as one *NCP* dissenter did, that the opposite rule better encourages shareholders and directors to oversee corporate managers properly. *Id.* at 904 (Rivera-Soto, J., dissenting). As a third option, one might believe, as another *NCP* dissenter did, that imputation may appropriately shield a negligent party from liability, but not a party that knew of and disregarded an agent's fraud (as is alleged here). *Id.* at 891 (LaVecchia, J., dissenting). We believe that it would be inappropriate for us to make this policy judgment in the first instance, particularly in light of the magnitude and importance of this case to the Commonwealth.[3] Therefore, we respectfully petition the Supreme Court of Pennsylvania to instruct us as to the appropriate test under Pennsylvania law for deciding whether imputation is appropriate when the party invoking that doctrine is not conceded to be an innocent third party, but an alleged co-conspirator in the agent's fraud.[4]

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[3] We note that AHERF was the largest healthcare system in the Commonwealth, and that its bankruptcy was, at the time of filing, the largest non-profit health-care-system in bankruptcy in American history.

[4] The Committee has also argued that Pennsylvania law contains an innocent-decision-maker exception. The Committee, however, relies exclusively on a case from a bankruptcy court outside of Pennsylvania that fails to cite any Pennsylvania law, *see In re Adelphia Commc'ns Corp.*, 365 B.R. 24, 57 (Bankr. S.D.N.Y. 2007). Thus, on this issue we are not persuaded that the Committee has raised a question of Pennsylvania law worthy of certification. However, should the Supreme Court of Pennsylvania choose to accept certification on the questions presented, we leave it to the Court to decide whether to address these arguments.

B. *In Pari Delicto*

The Committee argues that even if the officers' conduct is imputed to AHERF, *in pari delicto* should not shield PwC from liability. This argument has several permutations, all of which revolve around the basic idea that it is inequitable to allow PwC to escape without liability while AHERF's creditors suffer. We held in *Lafferty* that, as a matter of federal bankruptcy law, the debtor-in-possession succeeds to the claims and defenses of the debtor as they existed at the filing of the bankruptcy petition. 267 F.3d at 357. That holding, which remains the law of this Circuit, is distinct from the question of how Pennsylvania law weighs the equities of the various parties in applying the *in pari delicto* doctrine. It is this latter issue on which we seek clarification.

In pari delicto is a murky area of law. It is an ill-defined group of doctrines that prevents courts from becoming involved in disputes in which the adverse parties are equally at fault.[5] Courts in Pennsylvania have not been of one mind as to whether the doctrine is legal or equitable. *Compare Sacco v. Twp. of Butler*, 863 A.2d 611, 615 n.3 (Pa. Commw. Ct. 2004) (referring to doctrine as "equitable") *with Feld & Sons, Inc. v.*

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[5] In *Cenco, Inc. v. Seidman & Seidman*, 686 F.2d 449, 453-54 (7th Cir. 1982) (Posner, J.) the Court characterized *in pari delicto* as a set of doctrines that embodies the general principle that a plaintiff who is as at fault as the defendant may not recover. In contract actions, the principle manifests itself as the doctrine that a promisor will not be held liable for a breach of contract if the promisee prevented the promisor's performance. In negligence actions, it is the doctrine of contributory negligence (now superseded in some instances by comparative negligence). In fraud actions, it is the principle that a person may only recover as a victim of fraud if he actually relied on the alleged misrepresentation, something a participant in the fraud cannot prove. In other words, *in pari delicto* is not so much a stand-alone doctrine as multiple doctrines that embody a common principle and often apply in similar ways across various causes of action.

Pechner, Dorfman, Wolfee, Rounick & Cabot, 458 A.2d 545, 548 (Pa. Super. Ct. 1983) (referring to the "common-law" doctrine of *in pari delicto*). Moreover, it is not clear from the few Pennsylvania cases invoking it how the doctrine applies to the causes of action at issue here: professional negligence, breach of contract, and aiding and abetting a breach of fiduciary duty.

The Committee argues that *in pari delicto*, like unclean hands, should not apply against a party that has not personally engaged in inequitable conduct, but rather has that conduct imputed through agency law. *See Universal Builders, Inc. v. Moon Motor Lodge, Inc.*, 244 A.2d 10, 13-14 (Pa. 1968) (holding that an employee's unclean hands should not be imputed to his employer) (citing *Art Metal Works, Inc. v. Abraham & Strauss*, 70 F.2d 641, 646 (2d Cir. 1934) (Learned Hand, J., dissenting), *original decree vacated and dissent adopted as opinion of the court on r'hrg*, 107 F.2d 944 (2d Cir. 1939)). PwC counters that our Court did not see any bar to applying the doctrine on the basis of imputed conduct in *Lafferty*. The contours of *in pari delicto* in Pennsylvania law are not clear, and the Committee has raised a serious argument, albeit one that *Lafferty* seems to foreclose (though only for our Court). Moreover, *Lafferty*'s view of *in pari delicto* is a minority one.[6]

In addition, we are unsure whether the three causes of action presented here—professional negligence, breach of contract, and aiding and abetting a breach of

[6] *See* Sabin Willett, *The Shallows of Deepening Insolvency*, 60 Bus. Law. 549, 560 (2005) (collecting cases).

fiduciary duty—are subject to *in pari delicto* in the same way. In *Cenco*, the Seventh Circuit Court observed that *in pari delcito* applied in similar fashion to claims of negligence, breach of contract, and fraud, but it did not address aiding and abetting a breach of fiduciary duty.

Extending *in pari delicto* to a breach-of-fiduciary-duty action without guidance from the Supreme Court of Pennsylvania gives us pause. *In pari delicto* is generally not a valid defense for corporate directors alleged to have breached their fiduciary duties. The reason is obvious: if directors were allowed to have their misconduct imputed to the corporation for purposes of avoiding liability for breaching their duties *to the corporation*, shareholders and other corporate stakeholders would have little recourse against disloyal and careless corporate managers. Such a result would be, in the words of the Delaware Court of Chancery, “transparently silly.” *In re HealthSouth Corp. S’holders Litig.*, 845 A.2d 1096, 1107 (Del. Ch. 2003) (Strine, V.C.)

Whether it would make sense to allow *in pari delicto* to shield persons alleged to have knowingly aided and abetted this sort of misconduct, though, remains an open question. Unlike the other causes of action, aiding and abetting liability requires proof of *scienter*. Restatement (Second) of Torts § 867(b) (1979). Persons committing the tort are fully aware that they are acting *against* the corporation. It is not clear to us that the corporation’s fault should be considered equal to that of persons who knowingly act against it.

Given the questions surrounding the *Lafferty* holding, the need for clarification of the *in pari delicto* doctrine under Pennsylvania law, and the presence of the aiding and abetting cause of action, we believe that the best course is to request that the Pennsylvania Supreme Court clarify the contours of *in pari delcito* under Pennsylvania law.

* * * * *

Now therefore, the following questions of law are certified to the Supreme Court of Pennsylvania for disposition according to the rules of that Court:

1. What is the proper test under Pennsylvania law for determining whether an agent's fraud should be imputed to the principal when it is an allegedly non-innocent third-party that seeks to invoke the law of imputation in order to shield itself from liability?

2. Does the doctrine of *in pari delicto* prevent a corporation from recovering against its accountants for breach of contract, professional negligence, or aiding and abetting a breach of fiduciary duty, if those accountants conspired with officers of the corporation to misstate the corporation's finances to the corporation's ultimate detriment?

This Court shall retain jurisdiction of the appeal pending resolution of this certification and its aftermath.

By the Court,

/s/ Thomas L. Ambro
Circuit Judge

A True Copy:

Marcia M. Waldron

Marcia M. Waldron, Clerk

Dated: July 1, 2008

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